Harrison Street

Alternative real estate opportunities across the risk-return spectrum

A Q&A with Christopher Merrill, Harrison Street's co-founder, chairman and CEO

In 2005, when Harrison Street launched its business with an exclusive focus of investing in nontraditional real estate sectors, such as student housing, senior housing, medical office and self-storage, it was forging a new path for institutional capital. Fast-forward 20 years later, Harrison Street's conviction has never been stronger for the sectors they refer to as demographic-driven real estate. Christopher Merrill, co-founder, chairman and CEO, discusses the origins of the firm's alternative real estate strategy, current market dynamics and prospects for the future.

What was the original investment thesis in 2005 for these asset classes, and does it differ or hold true today?

Harrison Street's original investment thesis centered on the belief that alternative real estate sectors benefit from resilient demand drivers and experience lower volatility than traditional real estate sectors, which tend to correlate more closely with the broader economic cycle with demand driven by GDP and job growth. In contrast, the demand for alternative sectors is driven primarily by life events, and in many cases, needs-based demand. The idea was, regardless of economic fluctuations, there would continue to be steady demand from the population for education, healthcare and storage, and the aging population would require specialized housing and medical care. Alternative real estate's demand, backed by long-term and secular demographic trends, in our opinion, would underpin the ongoing resilience and lower volatility of these sectors.

Two decades later, our thesis has held true. It has now been cycle-tested under a range of economic scenarios and "black swan" events, including the global financial crisis, a global pandemic, the highest level of inflation seen in 40 years, and a period of rapidly rising, high interest rates. Despite these unprecedented macroeconomic challenges, demand for alternative real estate has consistently demonstrated resilience and has now established a track record to substantiate its value within a diversified investment portfolio. Today, we are seeing a range of investors follow suit, looking to expand their exposure to alternative sectors.

What factors make today particularly compelling for investing in commercial real estate?

We believe now is a particularly opportune time to invest in commercial real estate, especially in alternative sectors, due to a confluence of favorable market conditions and demographic-driven demand, which continues to grow despite the macroeconomic uncertainty. During the past two years, the real estate market has undergone meaningful repricing, with valuations adjusting downward, creating an attractive entry point for investors. Additionally, the higher interest-rate environment and tightened lending conditions have slowed new construction, leading to a significant drop in new supply across sectors.

At the same time, alternative sectors have continued to show strong demand and positive growth, even amid macroeconomic headwinds. We believe the combination of constrained supply, increasing demand and solid fundamentals will continue to drive one of the most favorable operating environments in our two-decade history of investing in alternative real estate. This confluence of factors offers investors a strategic opportunity to enter or expand within these sectors at more favorable valuations, positioning them to capitalize on the long-term growth and resilience of these assets.

Given the current market dynamics, is now the time to invest in core real estate?

At Harrison Street, we have long championed the idea that alternative real estate is underpinned by core fundamentals – namely its resilient demand that supports durable income and minimizes volatility. We were the first to launch a core diversified strategy exclusively investing in alternative real estate, and nearly 13 years later, our core investments across 400 properties continue to validate our thesis.

While we have consistently supported core investment across alternatives, industry-wide real estate portfolios have historically lacked sufficient diversity in alternative property types. In recent years, and perhaps in part due to the instability in certain traditional sectors, we have seen a broader shift in how the industry defines core investments. This evolution is underscored by the National Council of Real Estate Investment Fiduciaries' decision to expand its flagship indices, including the NFI-ODCE index, to include alternative real estate sectors – a progression that aligns with the approach we identified and embraced early on.

When thinking about risk-return profiles more broadly, the fundamental reasons to invest in high-quality core assets – stable income, inflation protection and diversification benefits – remain as relevant today as ever. With new supply constrained across key sectors that benefit from resilient and growing demand, coupled with the recent repricing of fundamentally sound assets, we believe this is a pivotal moment for investors to consider allocations to core alternative real estate and a good time to be an owner of these assets.

What is the opportunity today for noncore investments in alternative real estate?

As an active and dedicated alternative real estate investor across all points of a market cycle, we think today's environment offers compelling opportunities, especially within appropriately structured development projects. We believe these projects offer the most attractive risk-adjusted returns today, driven by strong and growing demand for alternative real estate, which continues to outpace supply.

During the past two years, liquidity constraints have led to a significant slowdown in new supply, creating a gap that experienced sponsors are positioned to fill. With the ability to access debt markets, secure prime sites in high-barrier markets and leverage operational expertise, experienced investors can manufacture high-quality assets in sought-after alternative sectors. It is our belief global capital will continue to rotate into our target sectors, increasingly seeking stabilized core investments and further strengthening the opportunity.

With $10 billion in fully realized development projects, we continually incorporate expertise gained from our early-mover advantage, which informs our targeted investment approach for each sector. We believe it is paramount to invest with established operating partners that have a track record of delivering assets on time, standing by their obligations and possessing operational expertise to mitigate risks associated with development. Our investment structures focus on providing downside protection, eliminating or significantly reducing entitlement or permitting risk, cost overruns and loan recourse exposure, thus incorporating disciplined risk management throughout an investment's life cycle.

What are your highest conviction sectors as we enter 2025?

As we enter 2025, our highest conviction sectors in alternative real estate are senior housing, student housing and data centers, each driven by strong demand and constrained supply. We estimate the growing aging population, assuming no change in today's senior housing usage rate, will require 40,000 new units to be delivered every year for the next 10 years. Construction activity, however, has been at its lowest point since 2014, with no foreseeable uptick, creating a significant gap that should persist for the next several years.

Students with parental support have demonstrated their unwavering preference for a traditional residential college experience. Power-4 universities continue to grow enrollment and experience record levels of freshman classes, fueling strong student housing occupancy and an average 6.1 percent rent growth during the past three academic years.

Data storage, processing and transmission capacity is mission critical in today's highly digital world. With the continued adoption of artificial intelligence applications, along with limited land and power availability in key markets, the demand for data centers continues to outpace supply. Continued data center investments are critical to meet growing data production needs, which have surged at a compound annual growth rate of 32 percent during the past decade, and we believe are on pace to further accelerate.

With increasing competition in alternative real estate, how do you view its impact on the market?

I believe competition is beneficial. It further legitimizes the maturation of the alternative sectors and fosters the development of a robust market, which is essential for facilitating transactions and creating liquidity. Our longstanding philosophy of aggregating fragmented lower-middle market assets and delivering scale to the market should aid us in an environment of increasing capital rotation into our sectors. With two decades of experience and nearly $70 billion of investments in the alternative space, we have accumulated significant knowledge and proprietary data to continually strengthen our strategy for each of these highly specialized sectors. Our extensive network comprising leading operating partners, universities and health systems strengthens everything we do. Our team's expertise and approach differentiate us. More competition entering the space pushes us to innovate and be even better, ultimately benefiting both the market and our approach. It's a positive force that drives growth and elevates the standards within the industry.

CONTRIBUTOR

Christopher Merrill

Co-Founder, Chairman and CEO

Harrison Street

Christopher Merrill is the co-founder, chairman and CEO of Harrison Street, a real assets investment management firm he co-founded in 2005, which has completed more than $68 billion in transactional volume and, as of second quarter 2024, has nearly $55 billion in assets under management. Merrill is currently the largest individual shareholder and serves as chairman of the board and the investment and executive committees of the firm. In 2022, he was recognized as Private Equity Real Estate's Industry Figure of the Year: Global. Merill also serves on the board of the Pension Real Estate Association, Rush University Medical Board (facilities committee), University of Wisconsin Graaskamp Center for Real Estate, TCU Center for Real Estate and a number of other real estate–related organizations.

CORPORATE OVERVIEW

Harrison Street is one of the leading investment management firms exclusively focused on alternative real assets. Since inception in 2005, the firm has created a series of differentiated investment solutions focused on demographic-driven, needs-based assets. The firm has invested across senior housing, student housing, healthcare delivery, build-to-rent, life sciences and storage real estate, as well as social, utility and digital infrastructure. Headquartered in Chicago and London, with offices in Luxembourg, Madrid, New York, San Francisco, Seoul, Tokyo, Toronto and Washington, D.C., the firm has nearly 300 employees and approximately $56 billion in assets under management. Clients of the firm include a global institutional investor base domiciled in North America, Europe, Middle East, Asia and Latin America. Harrison Street was awarded Best Places to Work by Pensions & Investments for nine years and since 2019 has won 15 awards from PERE, including three for the 2023 Awards: Alternatives Investor of the Year – Global, Data Centers Investor of the Year – North America, and ESG Firm of the Year – North America. For more information, please visit **www.harrisonst.com.**

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